



Ms. Mary F. Rupp
 Secretary of the Board
 National Credit Union Administration
 1775 Duke Street
 Alexandria, Virginia 22314-3428

**RE: Comments on Advanced Notice of Proposed
 Rulemaking for Part 704, Corporate Credit Unions**

Dear Ms. Rupp:

On behalf of the members of Niagara's Choice Federal Credit Union, I would like to take this opportunity to comment on NCUA's Advance Notice of Proposed Rulemaking (ANPR) regarding the restructuring of the corporate credit union system.

Our credit union is a charter member of Members United Corporate FCU, and we have benefitted tremendously over these 32 years. The corporate system was designed by credit unions, and meets many needs, including, but not limited to, a system-owned depository; a source of liquidity; payment systems; and educational opportunities. The nationwide corporate system provides needed support for the entire credit union movement. I believe most credit unions view one corporate as their primary correspondent institution.

As a capital investor in our corporate, we support regulations that would tie capital investments by natural person credit unions in a corporate as a condition for obtaining services from the corporate. A commitment to longer-term capital should provide a needed source of long-term liquidity.

Although we do not hold membership in more than one corporate, we agree that corporate credit unions should be allowed the ability to obtain a national field of membership. This may be more important to natural person credit unions as corporate mergers will likely continue. Using the free market to determine how many corporates should exist seems to be the right approach.

The capital position of our own credit union has been enhanced by the ability to utilize our corporate's payment services and investments. Core benefits such as depository services and payment systems should be services that corporate credit unions are able to provide.

We recommend that NCUA set stringent guidelines for the qualifications of those individuals interested in serving on corporate boards. A review of the concept of term limits for corporate board members is appropriate.

Thank you for the opportunity to comment on this ANPR.

Sincerely,

Alfred Frosolone
 CEO

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April 3, 2006

National Credit Union Administration

Re: Comments for Advance Notice on Rulemaking for Part 704

1. The Role of Corporates in the Credit Union System

There certainly remains a vital role for the Corporates in the credit union system. That does not mean that this credit union is opposed to changes in the system, but the changes need to take into consideration the needs of natural person credit unions.

Payment system. Most credit unions rely upon the corporate system for payment and settlement systems. While large credit unions may be able to negotiate these services with separate vendors, that would be difficult for small and even medium size credit unions. Credit unions are not necessarily looking for multiple Corporates; one to provide investment services, one to provide payments, and another for liquidity needs. If all of these services are not available in a convenient source it increases the risk that larger credit union will look to other providers and diminish the economies of scale.

Liquidity and liquidity management. The ANPR states the primary role of Corporates has been to provide and ensure liquidity. While primary may not be the best way to describe this role, there is no doubt that liquidity is a core function of the Corporates. Here again the larger credit unions may have other options such as the FHLB, but those options are not readily available to smaller credit unions. Much of the current crisis stems from a liquidity problem with the Corporates. In order to better manage their liquidity Corporates need adequate measurement and reporting processes. A portion of liquidity should be set aside to fund settlement, taking into consideration cyclical needs. Liquidity contingency plans should include the ability for Corporates to borrow directly from the Central Liquidity Facility (CLF). A coordinated study of changes needed in the CLF should be made by the NCUA, trade groups, Corporates, and natural person credit unions with the goal of presenting to Congress specific proposals.

Field of membership issues. Considerable discussion has taken place among stakeholders about the role of increased competition in the current crisis. We wish to be very clear on this subject: increased competition among Corporates did not lead to the present situation. *Poor management decisions by the Corporates, the NCUA, and the large natural person credit unions that had the most influence on the Corporates combined with the bursting of a speculative bubble fueled by outright fraud, greed, and a lack of regulatory oversight in the financial markets brought us to this point.* In whatever remains of the American free market system after this is over, competition must be preserved.

Natural person credit unions across the country have demonstrated it is possible for credit unions to compete but at the same time to cooperate. That should be the spirit of the corporate credit union system

There has been a slow trend towards consolidation of the Corporates, and that should be accelerated. While there is not a "magic number", we assume there should be no fewer than five, but no more than ten Corporates. Too few will stifle innovation and leave natural person credit unions without enough meaningful choices. Over time, natural market forces should lead to sufficient changes in the corporate culture, product mix, and marketing strategy to give those choices. In order for that choice to exist, the remaining Corporates should all have national field of memberships. Ultimately, the number of corporate credit unions should be determined by their members, not the NCUA.

For this choice to exist credit unions must have the ability to change their preferred corporate. Corporates need stable membership capital, but there must be some manner for a credit union to leave one corporate for another. The best solution may be to have different options such as the ability for a natural person credit union to sell their capital or to give advance notice similar to how it is done now for term paid in capital (PIC).

While natural person credit unions should be able to join multiple corporate credit unions, the need to do so could be lessened if the Corporates initiated joint marketing agreements for their products and services. This would give Corporates that cooperate a competitive advantage over those who did not.

Expanded investment authority. There are some who place the blame for this crisis solely on the expanded investment authority granted to some Corporates. Such simple solutions rarely speak to the true nature of a problem. Corporate credit unions are competing with banks for the business of natural person credit unions, and they need to be given the tools necessary to compete. However, the Corporates must have the knowledge, experience, and controls to use such tools effectively. The NCUA should conduct an *unbiased* review of the effectiveness of their regulation of the corporate's expanded investment authority. Additional regulation may be necessary, but more effective oversight is the goal. That may require taking a "clean slate" approach, but that would be preferable to just adding redundant layers of regulation.

Structure: two-tier system. The two-tier system should be abolished. The functions of the large wholesale credit union will be unnecessary if there is consolidation among the Corporates. The current system led to a centralization of investment decision making at U.S. Central. While that may appear to have been a transfer of risk to U.S. Central, there was significant off balance sheet risk at the member Corporates. Ultimately that was also off balance sheet risk at the natural person credit unions that is being recognized as they write off their NCUSIF and PIC/member capital. Natural person credit unions were too far removed from U.S. Central, and most had little appreciation of the risk they faced.

The CUSO model may bring some efficiencies to the corporate system that the wholesale corporate credit unions were intended to achieve. Provided that economies of scale allow it, multiple CUSOs can bring the innovation and other benefits discussed earlier. In addition to the economies of scale, CUSOs can also facilitate the cooperation between the Corporates.

2. Corporate Capital

Core capital. We endorse the proposal to establish a minimum core capital ratio. This should be defined as GAAP Tier 1 capital (retained & undivided earnings and perpetual paid-in capital). We also endorse two targets for this capital ratio. One should be achievable in the near-term (five years or less) and the other over a longer term. It must be remembered that the Corporates do not have access to the same sources of capital that are available to banks.

It was requested that commenters share their reactions to a proposal for Corporates to limit their services to only those credit unions that maintain core capital with the corporate. Core capital deposits are key to the recapitalization of the corporate system. Corporates that do not require core capital deposits would be able to pick up members "on the cheap". However, requiring the full deposit of member shares, term PIC, and perpetual PIC will restrict credit union's ability to choose from competing Corporates. A reasonable approach would be to index these capital deposits to the services used by members. In combination with that, services should be priced so that services are discounted to those who have higher capital participation. The higher fees paid by some credit unions would flow through to retained earnings and strengthen capital in that way. Such indexing should not be structured to put small credit unions at a disadvantage.

Membership capital. Membership capital shares should be retained until the corporate reaches the long range target discussed above. Membership capital requirements should be adjusted multiple times through the year (ideally on a quarterly basis). Once Corporates reach their long range target, they should have the ability to return MCS to their members, provided the corporate can meet its capital needs.

Risk-based capital and contributed capital requirements. The NCUA should consider risk-based capital in a manner consistent with other federally regulated financial institutions. See the discussion of Core capital for comments on requirements for natural person credit unions to maintain contributed capital at a corporate.

3. Permissible Investments

Corporate credit unions have very different investment needs than natural person credit unions. Therefore, their permissible investments should be different from natural person credit unions. Earlier there was mention of a need for NCUA to review its regulation of the corporate's investment powers. Included in that review should be an examination of permissible investments, but that review must consider permissible investments in the context of the needs of the corporate credit unions.

There needs to be a process in place for a review of new investment types. In recent years a regulatory climate existed in which investment types were created, and the regulation of those types came later. In some instances regulation only came about after a financial catastrophe occurred. For all credit unions, the regulatory review must come before these investments become part of the credit union balance sheets. The question arises as to who should conduct this review. We have seen in recent years that regulatory agencies sometimes lacked the resources to fully understand the risks associated with these

investments. Independent third parties can bring valuable expertise to this process, and should be used in conjunction with agency staff. Finally, our country is a democracy in which competing groups come to power. Trends of increasing or decreasing regulation occur over periods of decades. While the NCUA as an agency is not political, the people within the agency are influenced by their political beliefs, the environment in which they operate, and the philosophy of the board members appointed by the President. To the highest degree possible, a review of permissible investments should be free of any political or philosophical bias.

4. Credit Risk Management

Corporate credit risk management relied too heavily on the credit ratings assigned by Nationally Recognized Statistical Rating Organizations (NRSRO). Correcting the problems in those agencies is beyond the scope of the NCUA. As a result, the NRSRO's usefulness in assessing credit risk has been greatly diminished. Even using multiple rating agencies does not address the problems inherent in the ratings. Therefore, external reviews by qualified third parties of both new and existing investment types must be the new standard.

Other controls should be implemented over such areas as cash flow and duration, concentration limits, and diversification. In these areas it will be necessary for the NCUA to provide ongoing guidance as opposed to rigid regulations. The NCUA must be nimble enough to keep up with changes in the investment industry.

The use of third party reviews to measure and monitor credit risk means that these third parties must be independent. Multiple third parties should also be used, either by changing reviewers periodically or conduction validation reviews. Otherwise, we run the risk of some of the same problems that resulted from relying upon the NRSROs.

5. Asset Liability Management

We believe that the NCUA should reinstate requirements for Corporates to model the following:

- Net interest income
- Net income
- Net economic value
- Credit spread increases

Corporates should explore alternative methodologies with the goal of better modeling their ALM risk. Corporates should also use third party validation of their risk analysis. Corporates and the NCUA must put into place new processes to understand changes that will be occurring in the economic environment as we come out of this recession. The law of unintended consequences means our attempts to fix current problems will inevitably lead to new ones. Their needs to be assigned now the task of anticipating those consequences and preparing strategies to cope with them.

6. Corporate Governance

Each corporate should be allowed to maintain their own minimum standards for qualifications and ongoing training. The NCUA should review those standards to ensure they are adequate for the activities of the corporate. Each corporate should conduct peer reviews of their volunteers, with deficiencies addressed through training and disclosure to member credit unions. Corporates should also provide training to natural person credit union executives that have an interest in serving on the Corporate's board so that a diverse pool of talent is available. While opposed to term limits in principle, we believe that is a decision best left to the members of the individual corporate credit unions.

We are opposed to the compensation of directors. Certainly directors should be reimbursed for all expenses, including training and travel. Directors are salaried employees of the member natural person credit unions. The boards of those natural person credit unions permit their salaried employee to take time from their duties at the credit union to serve the corporate credit union. An argument can be made that the natural person credit union employing the director could legitimately request reimbursement for the cost to their credit union of allowing its employee to serve on the board. We would not be opposed to such a reimbursement to the credit union. However, such a reimbursement should be set by an independent committee consisting of representatives from member credit unions. Those representatives should not be former or prospective board members (within a reasonable time frame). The reimbursement should be based upon the duties of the directors (i.e. chairman's credit union receives more than a non-officer since assumption is he spends more time on duties).

We are also opposed to outside directors. There are significant differences between governance in the for-profit business model and not-for-profit business model. Corporate credit unions are owned solely by their member natural person credit unions, and those are the only ones who should be represented on the board of directors. Boards are free to hire consultants to bring outside perspectives to them, but they are not to be voting members of the Board.

While there have not been the egregious abuses of compensation in the corporate credit union system that exist in the for-profit financial institutions, members of the Corporates should have access to salary and benefit information on senior management.

7. Comments on Other Relevant Issues

Office of Corporate Credit Unions. The NCUA should retain the OCCU or an equivalent function that is staffed with people qualified to regulate the unique nature of corporate credit unions.

Greater Corporate Transparency. Corporate credit unions should be required to provide their members regular monthly reports of their financial statements as well as a summary of their investment positions. The corporate's annual report should detail the Corporates investment and risk management functions. Natural person credit unions should be reminded on a regular basis of the risk their capital deposits face at their corporate.

Role of Large and Small Credit Unions. Corporate credit unions are a key part of what we like to call the symbiotic relationship between large and small credit unions. Although even the largest credit unions do not approach the size of big banks, they are large enough to be able to establish relationships for payment, settlement, liquidity, and investment that small credit unions cannot establish. Their presence in the corporate credit union system adds to the economies of scale that allow small credit unions to offer a wide range of services to their members. Small credit unions are able to very clearly demonstrate the unique nature of how we serve our members to decision makers in government. This helps preserve our tax free status, and so they provide a benefit to the large credit unions. This symbiotic relationship has many dimensions, but the corporate credit unions system is such a key part of it that if the Corporates were to go away that relationship could well also disappear.

Review of NCUA Actions. Notably lacking in the ANPR were references to requests for comments on how the NCUA could have better handled this crisis once it unfolded. Although much of the ANPR does seek comment on changes in regulation of Corporates that could prevent a recurrence of this crisis, there is a lack self-examination evident here. Therefore, we respectfully suggest an external third-party review of the following:

- Were expanded investment powers given appropriately?
- Did the OCCU adequately oversee the investment and liquidity management of the Corporates? Were NCUA staff qualified for the roles they were assigned to?
- Did NCUA staff adequately consider alternatives to the actions they announced on January 28, 2009?
- At what point was the decision made for conservatorship of U.S. Central and Wescorp? Since those decisions were made have subsequent decisions and actions been taken so as to not cast doubt on the validity of those initial decisions instead of what is best for the credit union system? In other words, are NCUA staff members covering up mistakes?
- When the conservatorship was enacted the NCUA was ready with a CEO and 70 trained examiners. When did they begin assembling this team?
- There are apparent inconsistencies reported between public statements made by the new CEO of U.S. Central, senior NCUA staff, and official announcements by the agency. Are these inconsistencies significant, and what do they say about a possible hidden agenda by NCUA staff members?
- Have actions taken by the NCUA unnecessarily hurt the credit union brand in the eyes of consumers?
- Considerable confusion exists in early April about the proper accounting of the impairment and insurance assessment, despite (or because of) two accounting bulletins from the NCUA, a FASB pronouncement on OTTI, and an AICPA Technical Practice Aid. Could the NCUA have acted in a way such that there would have been less confusion and more orderly reporting?
- Is the perception by many credit unions that there is a lack of transparency on the part of the NCUA accurate? If so, why did NCUA staff take this approach?

- CUNA President Dan Allen reported resistance from the NCUA Board to obtaining answers to questions. Was there an adverse assessment of the situation, and how could there be better cooperation in the future?
- Is there an inherent conflict in the dual roles of the NCUA as insurer and regulator?

Considerable anger exists among natural person credit unions over this crisis. For credit unions to direct this towards the NCUA may be unfair, but absent an independent review of these types of questions it will be difficult to improve relations between the regulator and the regulated. An atmosphere poisoned by suspicion and mistrust is in the interest of neither credit unions nor the NCUA.

Respectfully Submitted,

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